

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING #98-52**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether a corporation who allows its unrelated Tennessee manufacturer/supplier to use, without charge, tooling and returnable shipping containers and whose employees visit the Tennessee manufacturer/supplier's facilities on a monthly basis for consultation and to assure quality control of the parts being manufactured on contract is subject to Tennessee franchise, excise taxes.

SCOPE

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

FACTS

Corporation X is a manufacturer whose business facilities and manufacturing operations are located outside Tennessee. Corporation X's only contacts with Tennessee concern its business relationship with an unrelated third-party manufacturer located in Tennessee (hereinafter referred to as the "Tennessee Supplier"). Corporation X contracts with the Tennessee Supplier for the manufacture and purchase of component parts that are incorporated into the finished products manufactured by Corporation X outside Tennessee. Corporation X does not maintain any inventories or component parts in Tennessee.

In producing the component parts that are sold to Corporation X, the Tennessee Supplier utilizes tooling that is furnished without charge by Corporation X. The tooling furnished has a net book value of approximately \$[AMOUNT] and its fair

market value is approximately equal to its net book value. The net book value of Corporation X's assets is approximately \$[AMOUNT] so the tooling of \$[AMOUNT] amounts to approximately .0250% of total assets. Corporation X believes that the extent and value of the tooling it furnishes is incidental to its business and can be considered qualitatively and quantitatively de minimis.

In addition, Corporation X and the Tennessee Supplier utilize certain returnable containers that are owned by Corporation X. The Tennessee Supplier uses the containers to ship to Corporation X the component parts that it manufactures and sells under contract with Corporation X. The containers are empty when return-shipped by Corporation X to the Tennessee Supplier. No charge is made by Corporation X for the use of these containers and they are in more-or-less continuous motion between the Tennessee Supplier and Corporation X's facilities located outside Tennessee.

The returnable containers described above have a fair market value of approximately \$[AMOUNT] and a net book value of approximately \$[AMOUNT]. In relation to the \$[AMOUNT] approximate net book value of Corporation X's assets, the net book value of the returnable containers is .0233% ($\frac{\$[AMOUNT]}{\$[AMOUNT]}$) of total assets. The approximate fair market value and book value of the average number of containers that are actually located in Tennessee at any given time are \$[AMOUNT] and \$[AMOUNT] respectively. This means that the net book value of the average number of containers in Tennessee is .0134% ($\frac{\$[AMOUNT]}{\$[AMOUNT]}$) of the approximate net book value of total assets.

The approximate net book value of the tooling and average number of containers in Tennessee at any given time is \$[AMOUNT] ($\$[AMOUNT] + \$[AMOUNT]$). This is .0384% ($\frac{\$[AMOUNT]}{\$[AMOUNT]}$) of the approximate net book value of total assets. If the approximate net book value of all returnable containers is considered, the relationship of the approximate net book value of tooling and containers to the approximate net book value of all of Corporation X's assets is less than 1/2% ($\frac{\$[AMOUNT] + \$[AMOUNT]}{\$[AMOUNT]} = \frac{\$[AMOUNT]}{\$[AMOUNT]} = .0483\%$).

Corporation X does not maintain or utilize any real or personal property in Tennessee other than the tooling and containers described above. No offices, employees, agents or payroll are maintained by Corporation X in Tennessee. Employees of Corporation X do not manage or supervise any activity or process performed by the Tennessee supplier. However, employees of Corporation X make periodic visits to the Tennessee Supplier and its facilities for general consultation purposes in connection with quality control over the component parts manufacturing process. These visits are made by one or two employees of Corporation X on a monthly basis and involve plant tours to confirm the quality of the parts being manufactured.

Corporation X does not solicit or make any sales of its finished products within Tennessee. Corporation X sells all its finished products to an affiliated corporation (Corporation Y) that is located outside Tennessee. Finished products are shipped by Corporation X under "F.O.B."-Factory" terms via common carrier. The purchaser, Corporation Y, takes title to the finished products and bears the risk of loss when the products leave Corporation X's facility located outside Tennessee. Some finished products are ultimately destined for the affiliate's customers located in Tennessee. The affiliate has income/franchise tax nexus with all states having such a tax and is a current Tennessee taxpayer.

QUESTIONS PRESENTED

1. After the effective date of Chapter 1092 of the Public Acts of 1998, is Corporation X "doing business" in Tennessee so as to be subject to Tennessee's franchise, excise taxes?
2. Prior to the effective date of Chapter 1092 of the Public Acts of 1998, is Corporation X "doing business" in Tennessee so as to be subject to Tennessee's franchise, excise taxes?

RULINGS

1. No.
2. No.

ANALYSIS

Corporation X's connection with Tennessee is limited to the following three things:

1. It contracts with an unrelated Tennessee Supplier for the manufacturer of component parts that are incorporated into the finished products manufactured by Corporation X outside Tennessee.
2. It furnishes the Tennessee Supplier, at no cost, tooling and returnable containers that are used by the Tennessee Supplier in fulfilling its contract to manufacture parts for Corporation X.
3. On a monthly basis, it sends one or two employees into Tennessee to visit the Tennessee Supplier's facilities for consultation and to ensure quality control over the component parts manufacturing process.

Section 1(E) of Chapter 1092 of the Public Acts of 1998, signed into law by the Governor on May 19, 1998 and now codified as T.C.A. § 67-4-804(a)(7)(E),

provides that the following activities shall not be considered “doing business” in Tennessee so as to subject a corporation to Tennessee’s franchise, excise taxes.

(E) Physical presence in this state of an out-of-state entity’s equipment, tooling, inventory, and employees on a temporary basis, when:

(i) the activity in which such items and employees are engaged is not the pursuit, creation or maintenance, by the out-of-state entity or any entity that is affiliated with it, of a market in this state;

(ii) the equipment and tooling are not used, worked on or held in this state by an entity that is affiliated with the out-of-state entity;

(iii) the out-of-state entity’s employees have no control over the use or work done in this state by the in-state entity; and

(iv) the extent and value of such items, the number of such employees, and the number of days the employees work in this state, in the light of all the facts and circumstances, are qualitatively and quantitatively de minimis. Entities are affiliated with one another if either directly or indirectly controls the other, or if the entities are directly or indirectly controlled by a common parent.

The Tennessee activities of Corporation X fall squarely within the criteria set forth in T.C.A. § 67-4-804(a)(7)(E).

Corporation X does not solicit or make any sales of its finished products within Tennessee and has no market in Tennessee. It incorporates component parts, manufactured by the Tennessee Supplier, into its finished products and sells such finished products to its affiliate, Corporation Y, located in another state. Although some of the affiliate’s customers are located in Tennessee, the Tennessee activity engaged in by Corporation X through its employees, tooling and returnable containers is not in the pursuit, creation or maintenance of a Tennessee market by Corporation X or Corporation Y. Such activity is solely in pursuit of obtaining a supply of component parts to incorporate into the products Corporation X manufactures. Neither Corporation X nor Corporation Y are marketing the parts manufactured by the Tennessee Supplier. They are marketing the products manufactured by Corporation X.

The approximate net book value Corporation X’s tooling and returnable containers used by the Tennessee Supplier is, at the most, less than 1/2% ($\$[\text{AMOUNT}] \div \$[\text{AMOUNT}] = .0483\%$) of the approximate net book value of Corporation X’s total assets. Only one or two of Corporation X’s employees visit Tennessee each month to conduct plant tours of the Tennessee Supplier to confirm the quality of the parts being manufactured in Tennessee. The Tennessee Supplier is unrelated to Corporation X and Corporation X’s employees have no part in the management, control or supervision of the work done in Tennessee by the Tennessee Supplier.

When compared with Corporation X's \$[AMOUNT] asset book value, the tooling and the returnable containers owned by Corporation X and used by the Tennessee Supplier are qualitatively and quantitatively de minimis in the light of all the facts and circumstances presented. Likewise, the performance of general consultation, plant tours and the confirmation of the quality of parts being manufactured by the Tennessee Supplier by one or two of Corporation X's employees in Tennessee on a temporary basis each month is also qualitatively and quantitatively de minimis in the light of all the facts and circumstances presented.

It is the Department of Revenue's position that T.C.A. § 67-4-804(a)(7)(E) merely codified the Department's long-standing practice with regard to having tooling or other property and employees in Tennessee on a temporary basis for purposes of quality control with regard to a Tennessee manufacturer who is manufacturing component parts to be used by an out of state corporation in manufacturing its products. In other words, the new law did not change anything. If a corporation has no franchise, excise nexus in Tennessee under T.C.A. § 67-4-804(a)(7)(E), it had no franchise, excise nexus prior to its passage and vice versa.

Under the facts and circumstances presented, Corporation X is not subject to Tennessee franchise, excise taxes either before or after the passage of Section 1(E) of Chapter 1092 of the Public Acts of 1998 signed into law by the Governor on May 19, 1998 and now codified as T.C.A. § 67-4-804(a)(7)(E).

Arnold B. Clapp, Senior Tax Counsel

APPROVED: Ruth E. Johnson, Commissioner

DATE: 12-18-98